

Philippines central bank on a stabilisation path...for now

The central bank raised policy rate by 25bps to 3.5% after last month's tightening, in a bid to stabilise inflation expectations. We think another rate hike is possible later this year and two more in 2019 to moderate the peso's depreciation back to around two percent in 2019



Source: Shutterstock

3.5%

Policy rate

Second consecutive hike in two meetings

As expected

Philippine's central bank hiked the overnight policy rate further not only to stabilise inflation expectations but also bring expectations within the target range over the policy horizon.

Bangko Sentral ng Pilipinas (BSP) expects inflation to remain elevated in 2018 and average at a downwardly revised 4.5% from the previous forecast of 4.6%. The BSP expects inflation to slow down to 3.3% which is lower than the previous forecast of 3.4%. Bloomberg consensus still expects around 3.5% inflation for 2019.

Another rate hike is possible later this year and two more in 2019 to moderate the peso's depreciation back to around two percent next year

The moderation of inflation reflects in part the government's efforts to address supply-related price pressures, slower oil price increases and more positive base effects. Headline inflation is seen to moderate or possibly stabilise starting this month. However, the peso is likely to remain under pressure for various reasons – deteriorating external payment balances, strong fiscal stimulus on top of favourable household and business spending and emerging market-negative external developments including a faster pace of US monetary tightening and trade fears.

The peso has been the worst performing Asian currency year-to-date losing almost 7% and recently trading at a 12-year low. Although the pass-through impact of inflation has moderated over the past decade, a significant depreciation still contributes to inflation pressures and fuels concern of inflation remaining at elevated levels.

We expect the tightening to help contain such concerns.

However, the central bank's hawkish tendency would be needed as emerging market sentiment remains weak and US monetary tightening continues with added pressure on moderating global liquidity in the next few years.

Another rate hike is possible later this year and two more in 2019 to moderate the peso's depreciation back to around two percent next year from this year's likely average depreciation of six to seven percent which would contribute to stabilising inflation expectations.